AGENDA

PARTNERSHIPS AND LIMITED LIABILITY COMPANIES COMMITTEE

Thursday, January 13, 2005
10:30 a.m. - 12:00 p.m.

Via Teleconference
Call In Number 1-800-304-8043
Passcode: 471976
Directions: Dial the 800 number, enter the passcode
and you will be connected accordingly

I. Administrative Matters

A.	Opening Remarks and Announcements	Johal
	1. Appoint Secretary	Johal
	2. Minutes from last meeting	Johal
B.	Membership	Johal
	1. Committee Webmaster	Brad Rogerson
C.	Executive Committee Liaison	Neil Wertlieb
D.	Liaison to Publications Committee	Ed Gartenberg
E.	Corporations Committee	Bruce Deming
F.	State Bar Annual Meeting	
G.	Secretary of State/AG's Opinion Letter	Phil Jelsma
H.	Business Law Section Annual Legislative Review	Johal/

II. Proposed Legislation

A.	Revised Limited Partnership Act (2001), Affirmative Legislative Proposal	Johal
B.	Legislative Developments	Johal

III. Recent Developments

A.	Stinky Love v. Lacy	Phil Jelsma
B.	Filo America v. Olhoss	Johal
C.	Nelson v. Morris	Johal
D.	In re Midpoint Development, LLC	Johal
E.	Harbison v. Strickland	Johal
F.	Gelinas v. Fuss	Johal
G.	Practice Issues	Johal

MINUTES OF

THE PARTNERSHIPS AND LIMITED LIABILITY COMPANIES COMMITTEE

OF THE BUSINESS LAW SECTION OF THE STATE BAR OF CALIFORNIA

December 9, 2004

10:30 a.m.

Via Teleconference

Members participating: Jack Johal, Charles McKee, Ed Gartenberg, Dan Winton, Michael Yoon, Bruce Denning, Joanne Rocks, Phil Jelsma, David Marion, Bradley Rogerson.

I. Administrative Matters.

(a) Opening Remarks and Announcements. Jack Johal brought the meeting to order at 10:30 a.m. Phil Jelsma agreed to serve as secretary.

(b) Membership. Jack mentioned that it was unclear who maintained a current list of the members of the Committee. Neil Wertleib, the liaison from the Executive Committee agreed to provide assistance in determining the exact membership. Bradley Rogerson agreed to serve as the Committee Webmaster.

(c) Executive Committee Liaisons. Neil Wertleib provided a report on behalf of the Executive Committee. Neil reminded the Committee that there is an SEI meeting coming up in January and the annual meeting of the Business Law Section will be in September in San Diego. Suggested topics were due by January 31, 2005.

(e) Corporations Committee. Bruce Demming has agreed to serve as the liaison from the corporations committee. He commented on the Corporations Committee's comments on SEC hedge funds and potential revisions to the California Securities Act. The Corporations Committee is attempting to come up with standardized venture capital documents for California corporations. The Corporations Committee is also working on a revision to the close corporation statute.

(f) Secretary of State/AG's Opinion. Phil Jelsma lead a discussion of AG Opinion No. 04-103 which was filed on July 23, 2004. It was agreed that the committee would contact the various licensing agencies to determine their interpretation of the opinion which permits nonprofessional licenses to be issued to LLCs. A copy of the draft letter is attached to the minutes.

(g) Business Law Section; Annual Legislative Review. Mr. Johal requested volunteers to prepare the annual legislative review. Mr. Jelsma mentioned that it was his understanding that Denise Olrich may be preparing this on behalf of the Committee.

II. Proposed Legislation-Revised Limited Partnership Act-Affirmative Legislative Proposal.

Larry Doyle then explained that the RE-RULPA bill would be submitted to Assemblyman Tom Harman's office who would serve as author of the bill in the current term. Mr. Jelsma reminded the members that democratic co-authors will be extremely important to the RE-RULPA bill and suggested that efforts be made to solicit Democratic support.

III. Recent Developments

Mr. Johal lead a discussion of Reggio v. Vining and Monte Carlo v. Willy Yorro. Mr. Jelsma covered Revenue Ruling 2004-77, where a limited partnership with a disregarded LLC as a general partner was treated as a disregarded entity. Mr. Jelsma also mentioned the Stinky Love Inc. v. Lee Lavy case, which is attached to the minutes.

There was a brief discussion of practice issues and the meeting concluded at 12:00 pm.

Respectfully Submitted

Phillip L. Jelsma, Secretary

Jack S. Johal

From: Peter Szurley [szurley@chapman.com]
Sent: Tuesday, January 04, 2005 5:27 PM
To: BLS Standing Committee Chairs/Vice Chairs 2003-04
Cc: Suzanne Graeser S.; Orloff Susan
Subject: State Bar Annual Meeting Programs (October, 2005)

Happy New Year BLS Standing Committee Chairs and Vice-Chairs!

I have the pleasure of coordinating all of the CLE programs for the BLS for the upcoming State Bar Annual Meeting in 2005. That meeting will take place *October 8-11, 2005 in San Diego.*

Presenting a program at the Annual Meeting is a wonderful opportunity for each standing committee to showcase not only the important issues it has been addressing but also the talents and dedication of its members. It is also a great way to seek out new members and promote the committee's goals and objectives.

As you can imagine, the Annual Meeting requires considerable advance planning (especially given the coordination of the programs of the various sections). This e-mail is a reminder that **the first deadline for the standing committees regarding the Annual Meeting is Monday, January 31, 2005**.

By **January 31, 2005**, each standing committee should provide me with the following information regarding a program to be sponsored by that committee at the Annual Meeting (or a statement to the effect that that committee will not be putting on a program):

1. The program topic (a title if you have it; a specific topic if you do not);
2. The program length (programs may be either 1, 2 or 3 hours);
3. A brief (2-3 sentence) description of what the program will cover; and
4. A preference for date/time if you have one (although there are no guarantees on this, or, quite frankly, any other front).

So you know, there will be only two more deadlines following January 31st: a date in early May for submission of the names of all panelists, and a date in mid to late August for submission of written materials.

I will be following up with you later this month to ensure we meet the first deadline. If I may be of any assistance in the process, please let me know.

A few final notes:

A. The BLS receives a total of five (count'em, only five) guaranteed program slots for the Annual Meeting. In the past, however, we have sometimes been able to put on up to ten programs (last year was an example). So, while we encourage all submissions, there are no guarantees (and there may be disappointment).
B. If your committee submits your program(s) first, that does not mean that your committee's program(s) are guaranteed inclusion.
C. Consider putting on programs jointly with another standing committee -- it's a great way to broaden your audience (and might -- I say might -- increase the chance of the program being selected).

D. **Please note that the January 31, 2005 deadline marks an extension of the January 25, 2005 date contained in the Quick Start Guide that was handed out to all Standing Committee Chairs and Vice Chairs. The deadline cannot be extended beyond January 31, 2005**, otherwise, Susan Orloff will have my head (and, to be honest, she doesn't really want it).

Best regards,

Peter

Peter S. Szurley
Chapman and Cutler LLP
595 Market Street, Suite 2600
San Francisco, CA 94105
Telephone: 415.541.0500
Telefacsimile: 415.541.0506
Direct Dial: 415.278.9030
E-mail: szurley@chapman.com

Dear [DCA Agency]:

I am contacting you as a chair of the Partnerships and LLC Committee of the Business Law Section of the California State Bar. Our Committee publishes a book for members of the State Bar entitled "Organizing and Operating Limited Liability Companies in California." That book generally provides advice to members of the Bar and business community concerning whether an LLC can obtain a license, certification or registration pursuant to the Business and Professions Code. In light of the Attorney General Opinion 04-103 (a copy of which is attached) which allows LLCs to provide nonprofessional, occupational services, we would be interested in determining whether or not the licenses, certifications or registrations issued by your agency or bureau will be granted to LLCs. In particular, we would be interested in obtaining your opinion whether the following licenses, certifications or registrations can be granted to a limited liability company:

Please feel free to respond via the attached sheet, where you can simply check whether the licenses, certifications or registrations described will be granted to an LLC.

If you have questions, please do not hesitate to contact me at _____.

Very truly yours,

WORKSHEET

License or Profession	Will be granted to LLC	Will not be granted to LLC

Jack S. Johal

From: Linda A. Turner
Sent: Monday, January 03, 2005 1:28 PM
To: _Business Attorneys; _Business Legal Assistants
Cc: Loretta Armstrong; Pam Rolph
Subject: A Summary of New Legislation in California Affecting Business Entities from the Secretary of State Web Site

AB 1000
(Chapter 819)
Urgency Legislation
Eff. September 27, 2004

This measure makes changes to the California Corporate Disclosure Act, which requires publicly traded domestic stock and foreign corporations to file a corporate disclosure statement containing specified information. AB 1000 took effect September 27, 2004, as an urgency measure. The primary changes are as follows:

- The corporate disclosure statement must be filed separately from the statement of information, and the corporate disclosure statement must be filed annually within 150 days after the end of the corporation's fiscal year.
- Removes the requirement to include the date of the last report prepared for the corporation by the independent auditor and the requirement to attach a copy of the most recent independent auditor's report.
- Clarifies the terms *publicly traded corporation, executive officer, compensation,* and *loan.*
- Requires the name of the independent auditor that prepared the most recent auditor's report and, if different, the name of the independent auditor employed by the corporation on the date of the statement.
- Changes the time period for reporting the description of other services performed by the independent auditor to the two most recent fiscal years and the period between the end of its most recent fiscal year and the date of the statement.
- Requires the compensation paid to the chief executive officer if the chief executive officer is not among the five most highly compensated executive officers of the corporation.
- Requires a description of any loan to directors made at an interest rate lower than the interest rate available from unaffiliated commercial lenders generally to a similarly-situated borrower rather than loans at a preferential rate. Loans must be reported for the two most recent fiscal years rather than the previous 24 months.
- Requires a statement indicating whether an order for relief has been entered in a bankruptcy case rather than a statement indicating whether any bankruptcy was filed. Clarifies that the time period for reporting this information is 10 years preceding the date of the statement.
- Requires a statement indicating whether any member of the board of directors or executive officer of the corporation has been convicted of fraud within the previous 10 years only if the conviction has not been overturned or expunged. Clarifies that the time period for reporting this information is 10 years preceding the date of the statement.

- Requires a description of any material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which the corporation or any of its subsidiaries is a party or of which any of their property is the subject, as specified by Item 103 of Regulation S-K of the Securities Exchange Commission (Section 229.103 of Title 12 of the Code of Federal Regulations).

- Requires a description of any material legal proceeding during which the corporation was found legally liable by entry of a final judgment or final order that was not overturned on appeal during five years preceding the date of the statement.

AB 1776

(Chapter 629) This measure provides that a foreign corporation that designates an agent for service of process pursuant to the requirements of Corporations Code section 2105(a)(4) consents to the service of any validly issued and properly served search warrant for records or documents that are in the possession of the foreign corporation and are located inside or outside of California. It defines "properly served" to mean delivery by hand, or in a manner reasonably allowing for proof of delivery if delivered by U.S. mail, overnight delivery service, or fax to a person or entity listed in Corporations Code section 2110.

AB 1859

(Chapter 416) This measure creates a short-form cancellation process for a domestic limited liability company that filed its articles of organization on or after January 1, 2004, and meets the following requirements:

- The certificate of cancellation must be executed and acknowledged by a majority of the members, or if there are no members, a majority of the managers, if any, or if no members or managers, the person or a majority of the persons who signed the articles of organization.

- The certificate of cancellation must be filed within 12 months from the date the articles of organization were filed.

- The limited liability company must not have any debts or other liabilities, except for state tax liabilities.

- The certificate of cancellation must include a statement that the tax liability of the limited liability company will be satisfied on a taxes-paid basis or that a person, limited liability company, or other business entity assumes the tax liability, if any, of the dissolving limited liability company as security for the issuance of a tax clearance certificate from the Franchise Tax Board and is responsible for additional taxes or fees, if any, that are assessed under the Revenue and Taxation Code and become due after the date of the assumption of the tax liability.

- The final tax return for the limited liability company must have been filed with the Franchise Tax Board.

- The known remaining assets for the limited liability company after all debts and liabilities have been paid or otherwise provided for must have been distributed to the persons entitled to them or a statement must be made that the limited liability company acquired no known assets.

- The limited liability company must not have conducted any business from the time of filing the articles of organization.

- A majority of the managers or members must have voted, or if there are no managers or members, the person or a majority of the persons who signed the articles of organization must have voted, to dissolve the limited liability company.

- If the limited liability company received payments for interests from investors, those payments must have been returned to the investors.

This measure exempts a limited liability company that files a certificate of cancellation pursuant to this process from the requirement to obtain a tax clearance certificate and from paying the minimum franchise tax normally required pursuant to the Revenue and Taxation Code. However, it does not allow for reimbursement of taxes that have already been paid.

AB 1955

(Chapter 376) This measure allows a domestic for-profit life insurer to be organized as a nonprofit mutual benefit corporation. A domestic life insurer organized under the Nonprofit Mutual Benefit Corporation Law would be subject to all of the provisions applicable to a domestic incorporated stock life insurer pursuant to the Insurance Code.

AB 3073

(Chapter 354) This measure, which took effect August 30, 2004, as a tax levy, contains numerous provisions concerning property owned by limited liability companies. The provision of the bill that affects the Secretary of State's office is found in newly amended Corporations Code section 17002, which specifies that a limited liability company may engage in not-for-profit activities.

SB 1746

(Chapter 178)

This measure repeals current provisions concerning unincorporated associations, enacts new provisions, and makes conforming changes relative to the liability of members of unincorporated associations. It also exempts labor organizations, labor federations, labor councils, and labor committees that are governed by constitutions or by-laws from the provisions of the Corporations Code that regulate unincorporated associations.

SB 1913

(Chapter 695)

This measure exempts professional corporations rendering professional services by persons licensed by the Speech-Language Pathology and Audiology Board from the requirement to obtain a certificate of registration. It also eliminates the restriction that a chiropractic corporation include in its name *only* the name or the last name of one or more of the present, prospective, or former shareholders and the words "chiropractic" and "corporation" or wording or abbreviations denoting corporate existence.

Linda A. Turner
Senior Legal Assistant
Hanson, Bridgett, Marcus, Vlahos & Rudy
333 Market Street, Suite 2300
San Francisco, CA 94105-2173
Tel: (415) 995-5147
Fax: (415) 541-9366

1ST CASE of Level 1 printed in FULL format.

STINKY LOVE, INC., Plaintiff and Respondent, v. N. LEE LACY, Defendant and Appellant.

B163377

COURT OF APPEAL OF CALIFORNIA, SECOND APPELLATE DISTRICT, DIVISION TWO

2004 Cal. App. Unpub. LEXIS 7497

August 13, 2004, Filed

PRIOR HISTORY: APPEAL from a judgment of the Superior Court of Los Angeles County, No. BC223980. Morris B. Jones, Judge.

DISPOSITION: Affirmed.

CORE TERMS: alter ego, capitalized, entity, film, financial officer, purchase price, alter ego doctrine, capitalization, advertising, print, paying, rent, shareholder, corporate veil, own money, movie, ownership, dollars, separate entity, inequitable, substantial evidence, personally liable, undercapitalized, distributorship, related-party, disbursements, renegotiated, separateness, distributor, domination

COUNSEL: O'Laverty & Ungar, Robert M. Ungar for Defendant and Appellant.

Alschuler Grossman Stein & Kahan, Lawrence C. Hinkle II for Plaintiff and Respondent.

JUDGES: BOREN, P.J.; NOTT, J., ASHMANN-GERST, J. Concurred.

OPINIONBY: BOREN

OPINION: The trial court pierced the corporate veil, holding the chief executive of a limited liability company personally liable for a judgment against the company. The court's decision is supported by substantial evidence. We affirm.

FACTS

Formation and Capitalization of Independent Artists

N. Lee Lacy was the president--and later the chairman--of Independent Artists (Independent), a closely held limited liability company. Lacy sought to enter the field of motion picture distribution. A distributor[*2] promotes films, places them in theaters, and sells them abroad. Movie distribution is an enterprise that requires enormous capital to operate successfully. Indeed, it ordinarily costs a distributor millions to meet its financial obligations to distribute a single film.

To accomplish his objectives, Lacy tried to raise $ 30 million in capital from investors, and hoped to leverage that sum into $ 100 million. Lacy was unsuccessful in raising outside money for Independent. Instead, he capitalized Independent himself in February 1999, with $ 1 million of his own money and $ 150,000 from a company he controls. Lacy entered a loan agreement with Independent that did not require him to loan any money to the company, and he entered an equity agreement with Independent that did not require him to invest any money in the company. Lacy and his family control 100 percent of Independent.

From time to time, Lacy made loans to Independent from his personal line of credit. Three million four hundred fifty-nine thousand dollars was obtained from an outside lender, although the money did not go directly to Independent. Instead, it went to a related company established by Lacy for the sole purpose [*3]of paying for movie prints and advertising.

Lacy closely managed the details of Independent's business and approved all expenditures. He did not allow Independent's chief financial officer to have access to the company's financial books or records. Only Lacy and his daughter were privy to Independent's financial information. The chief financial officer did review Lacy's personal balance sheet in 1999, which reflected that Lacy had $ 30 million in assets.

Independent's Agreement to Distribute Love Stinks

Shortly before Lacy capitalized Independent, in early 1999, the company contacted moviemaker Jeffrey Franklin and offered to distribute a new film made by Franklin called Love Stinks. Franklin had sunk $ 4 million of his own money into Love Stinks, which he wrote, produced, and directed through his production company, Stinky Love, Inc. (Stinky). Franklin was told by Independent's representatives that Independent was bankrolled to the tune of $ 30 million by its founder, Lee Lacy.

To persuade Franklin to do business with it, Independent sent him a "corporate overview" describing Independent as an award-winning, "premier $ 85 million per annum international film production[*4] company" to which Lacy has committed $ 30 million as "seed capital." Franklin was duly impressed by this. He decided that Independent was "very well capitalized."

Franklin met with Lacy and other Independent executives in early February 1999. At the meeting, Independent's executive vice-president and chief financial officer reiterated that Lacy had financed Independent with $ 30 million of his own money. Franklin had no reason to doubt Lacy's financial backing of Independent.

Stinky entered a distribution agreement with Independent, dated February

18, 1999, for the marketing of Love Stinks. Actually, there are two signed distribution agreements dated February 18, 1999. The first version required Independent to spend at least $ 5 million on prints and advertising. A subsequent, renegotiated version of the agreement in August 1999 required Independent to spend at least $ 8 million on prints and advertising. It also required Independent to pay Stinky $ 4.3 million as consideration for the distribution rights to Love Stinks, plus a portion of the gross receipts. The purchase price was due in three installments starting December 10, 1999.

At the Cannes Film Festival in May 1999, Independent[*5] marketed the film to foreign distributors, bringing in $ 2.3 million in foreign sales. Stinky soon began to doubt Independent's marketing strategy and the adequacy of its advertising budget. Lacy made assurances to Franklin's personal manager during a meeting in July 1999 that Independent was adequately capitalized with $ 30 million of his own money, therefore the company had the capacity to stand behind its guarantees so Franklin should trust and rely on him. Stinky's doubts were allayed by Lacy's guarantees of payment and claims of adequate capitalization of Independent. Moreover, Franklin felt comforted when a newspaper article featured Independent's chief financial officer, who guaranteed payment to Franklin even if total sales of the film were inadequate, because Independent's $ 30 million in private capitalization would make up any shortfall.

Stinky Love was released in September 1999 and fared poorly at the box office. Nevertheless, Franklin still believed that Independent would honor its financial obligations to Stinky, including payoff of the $ 4.35 million purchase price. However, when it came time to remit the $ 2 million due to Stinky on December 10, 1999, Independent's[*6] chief financial officer told Franklin that he was not going to be paid. Stinky never received a penny of the purchase price.

Independent's Financial Situation

At the time the first $ 2 million installment owed to Stinky came due, in December 1999, Independent's sole cash assets consisted of $ 373 in a checking account and a $ 50,000 cashier's check. Independent had lost $ 1.138 million in 1999 and $ 4.378 million in 2000. Lacy testified that his only source of funds to pay Stinky the $ 4.35 million purchase price was revenue to be generated by the film itself.

Independent's business expenses were high. For example, Independent rented office space in a building owned by Lacy on Melrose Place. In 1999, Independent paid Lacy over $ 267,000 in rent. In 2000, Independent paid Lacy over $ 263,000 in rent. In 1999, Independent spent $ 304,141 on improvements to the rental space in Lacy's building. Independent's payroll was $ 485,594 in 1999.

Michael Spindler, an accountant who specializes in fraud, examined Independent's financial records. Spindler identified factors indicating that Independent is the alter ego of Lacy. Spindler listed undercapitalization, lack of separateness[*7] in related party transactions, and domination and control by Lacy as indicia of alter ego.

a. Undercapitalization

Spindler compared Independent's financial commitments against the amount of funding the company received from Lacy. Given the company's commitments, its

ability to pay its obligations wholly depended upon the success of Love Stinks, a risky projection that was unlikely and unreasonable given the film's likely box office receipts. When Independent initially entered the distribution agreement with Stinky, it committed itself to pay $ 5.4 million, at a time when it had a capital account balance of $ 347,000. When the distributorship agreement was later renegotiated, Independent committed itself to pay Stinky $ 4.35 million plus expend at least $ 8 million on prints and advertising; at the time this commitment was made, Independent had a cash balance of $ 34,000 and equity of under $ 1.5 million.

It was unreasonable for Lacy to rely solely on the success of a single film to meet Independent's financial obligations. There was insufficient capital for Independent to meet its obligations and continue business operations. By December 1999, Independent was insolvent; [*8] i.e., it was unable to meet its obligations as they came due and had more liabilities than assets. Independent was "thinly capitalized compared to other companies in the [entertainment] industry."

b. Lack of Separateness in Related Party Transactions

Independent made disbursements on behalf of related parties, meaning Lacy himself or Lacy-related companies. In fact, Independent made 750 related-party disbursements in areas such as rent, improvements, auto expenses, and making payroll of other companies. For example, Independent's 1999 rental outlay of $ 267,000 was in large part ($ 176,000) related to other Lacy-controlled entities that occupied the same, Lacy-owned building. Independent's 1999 expenditure of $ 304,000 for leasehold improvements covered $ 216,000 in bills to other Lacy entities. Independent's 1999 salary expense of $ 486,000 included $ 379,000 that related to other Lacy-controlled entities.

Misuses of corporate funds were legion. They included paying off three Mercedes Benz automobiles belonging to Lacy; paying for costs on real property Lacy owned in Colorado (for stream bank stabilization, among other things); and preparation of Lacy's personal state[*9] and federal income tax returns. Independent made payments on over 30 credit cards, none of which were in Independent's name. Further, Independent paid $ 108,862 on the personal credit cards of Lacy's wife. To accomplish this shell game, Lacy had Independent direct its bank to make transfers among various accounts. Independent even paid money directly to Lacy's personal creditors, an unusual event that is an indicia of alter ego, because Lacy's personal finances were so entangled with Independent's finances.

c. Domination and Control

Lacy dominated and controlled Independent through his high ownership interest. He dominated Independent in other ways. For example, Lacy owned the building in which Independent paid great amounts of rent, and he directed money transfers among numerous bank accounts that he controlled, not only for Independent but for other entities as well.

PROCEDURAL HISTORY

Stinky filed suit against Independent and Lacy, then petitioned to compel arbitration pursuant to a binding arbitration clause in the distribution agreement. Lacy declared personal bankruptcy, claiming assets of $ 38 million,

minus liabilities. The arbitration proceeded against[*10] Independent, and Stinky prevailed on its breach of contract claim. The arbitrator found that Independent is obligated to pay Stinky $ 4.3 million. Independent has not paid the arbitration award, which was confirmed by the court and made into a judgment.

At Stinky's request, the bankruptcy court lifted the automatic stay and authorized Stinky to continue litigation against Lacy. Stinky then pursued its alter ego claims against Lacy. Following a bench trial, the court found that Lacy is the alter ego of Independent, and it amended the arbitration judgment to add Lacy as a judgment debtor.

In particular, the trial court found that Lacy dominated and controlled Independent; that there was a lack of separateness between Lacy and the company; that Independent was family-owned; that there were extensive related-party transactions; that the agreements between Lacy and Independent were not arm's-length transactions; that Independent paid substantial rent and made leasehold improvements on Lacy's property, and it also paid to prepare Lacy's personal tax returns, for the expenses of other Lacy companies, and for Lacy family credit cards; Independent was financially dependent upon Lacy to meet [*11]its financial obligations and Lacy controlled the flow of money to and from Independent and contributed or withdrew money at his whim. Beyond that, the court found that Independent was undercapitalized and insolvent.

DISCUSSION

1. Effect of Lacy's Bankruptcy Proceeding

It is undisputed that the bankruptcy court granted Stinky relief from the automatic stay that went into effect when Lacy declared bankruptcy, thereby allowing the trial court to proceed to a resolution of this lawsuit. The parties are currently engaged in a debate in bankruptcy court as to whether Lacy can discharge his debt to Stinky. Lacy asks this Court to interject itself into the ongoing proceedings in bankruptcy court by unilaterally declaring that Lacy's debt to Stinky has been discharged. We decline the invitation to meddle in the decisions of the bankruptcy court, or to usurp its exclusive federal* jurisdiction. If the bankruptcy court ultimately grants Lacy a discharge, so be it. Our role is limited to determining whether the trial court's judgment is supported by the law and substantial evidence.

2. Substantial Evidence Supports a Finding of Alter Ego

In reviewing the[*12] trial court's finding of alter ego, we apply the substantial evidence rule, indulging all reasonable inferences and resolving all conflicts in the evidence in favor of the trial court's judgment. (Sonora Diamond Corp. v. Superior Court (2000) 83 Cal.App.4th 523, 535 (Sonora); Associated Vendors, Inc. v. Oakland Meat Co. (1962) 210 Cal. App. 2d 825, 835, 26 Cal. Rptr. 806 (Associated).) "The power of the appellate court begins and ends with a determination as to whether there is any substantial evidence, contradicted or uncontradicted, which will support the conclusion reached by the trial judge." (Associated, at p. 835.) The testimony of a single witness may be sufficient, if the trial court finds it credible. (In re Marriage of Mix (1975) 14 Cal.3d 604, 614, 122 Cal. Rptr. 79.)

a. Scope of the Alter Ego Doctrine

The alter ego doctrine applies to members of limited liability companies. (Corp. Code, @ 17101, subd. (b).) "A corporate identity may be disregarded--the 'corporate veil' pierced--where an abuse of the corporate privilege justifies holding the equitable ownership of a corporation[*13] liable for the actions of the corporation." (Sonora, supra, 83 Cal.App.4th at p. 538.) "In California, two conditions must be met before the alter ego doctrine will be invoked. First, there must be such a unity of interest and ownership between the corporation and its equitable owner that the separate personalities of the corporation and the shareholder do not in reality exist. Second, there must be an inequitable result if the acts in question are treated as those of the corporation alone." (Ibid.)

Among the factors to be considered in applying the doctrine are commingling of funds and other assets; the failure to segregate the funds of the individual and the corporation; unauthorized diversions of corporate funds to noncorporate purposes; the treatment by an individual of corporate assets as his own; disregard of corporate formalities; the ownership of all the stock by a single individual or family; and domination or control of the corporation by the stockholders. An important factor is inadequate capitalization. (Mid-Century Ins. Co. v. Gardner (1992) 9 Cal.App.4th 1205, 1213, fn. 3; Sonora, supra, 83 Cal.App.4th at pp. 538-539;[*14] Roman Catholic Archbishop v. Superior Court (1971) 15 Cal. App. 3d 405, 411, 93 Cal. Rptr. 338; Associated, supra, 210 Cal. App. 2d at pp. 838-840.) Failure to maintain arm's-length relationships among related entities is a consideration, as is use of the corporation to procure labor, services or merchandise for another person or entity. (Associated, at p. 840.)

Mere failure to meet a financial obligation to a creditor does not prove misconduct or injustice. "The alter ego doctrine does not guard every unsatisfied creditor of a corporation but instead affords protection where some conduct amounting to bad faith makes it inequitable for the corporate owner to hide behind the corporate form." (Sonora, supra, 83 Cal.App.4th at p. 539.)

b. Unity of Interest and Ownership

The evidence points to the conclusion that Independent was no more than an extension of Lacy. The Lacy family owned Independent and used Independent's assets for their own benefit, paying off personal credit cards, automobile loans, and maintaining family-owned real property in Colorado. Respondent's accounting expert uncovered 750 different related-party[*15] disbursements totaling millions of dollars. Lacy did not respect Independent's corporate separateness, drawing no distinction between Independent and other entities he controlled, sharing office space and employees--in a Lacy-owned building--and having Independent pay for it. Independent depleted itself paying for bills that were rightfully the responsibility of other individuals and entities. Money moved freely between the accounts of Independent and Lacy. The evidence even showed that Independent directly paid off Lacy's personal creditors as a result of the entanglement of Lacy's finances with those of Independent. The Lacy family controlled Independent so completely that they denied the company's chief financial officer access to the company's financial books and records. From all of this, the trial court could reasonably deduce that Independent was a mere conduit for the Lacy family's activities.

There was ample evidence of inadequate capitalization. Lacy failed to raise the hoped-for $ 30 million in outside capital, and wound up capitalizing

Independent himself with a little more than a million dollars. Lacy's agreements with Independent did not require him to invest in or loan[*16] money to Independent. At the same time that he capitalized Independent, Lacy entered the distributorship agreement with Stinky. At the outset, this committed Independent to spend over $ 5 million on Love Stinks. Later, Independent upped its financial commitment to $ 12.4 million. Independent was, in other words, undercapitalized in light of its prospective liabilities. "'The policy of the law [is] that shareholders should in good faith put at the risk of the business unincumbered capital reasonably adequate for its prospective liabilities. If the capital is illusory or trifling compared with the business to be done and the risks of loss, this is a ground for denying the separate entity privilege.'" (Automotriz etc. De California v. Resnick (1957) 47 Cal.2d 792, 797 (Automotriz).)

"'The attempt to do corporate business without providing any sufficient basis of financial responsibility to creditors is an abuse of the separate entity and will be ineffectual to exempt the shareholders from corporate debts.'" (Claremont Press Pub. Co. v. Barksdale (1960) 187 Cal. App. 2d 813, 816, 10 Cal. Rptr. 214 (Claremont).) In Claremont, the defendant[*17] contributed only $ 500 as capital to a venture that incurred costs of $ 650 to $ 1,000 per week, and at least $ 10,000 was needed to adequately capitalize the operation. The defendant's other contributions "were but loans." (Id. at pp. 816-817.) Likewise, a shareholder's capital contribution of $ 5,000 to a car brokerage was deemed to be inadequate where the company's sales volume was between $ 100,000 and $ 150,000 per month. (Automotriz, supra, 47 Cal.2d at pp. 795, 797-798.)

There was no way that Independent could meet its financial obligations without revenue from Love Stinks. Yet the testimony showed that this was an unlikely and unreasonable reliance on the success of a single movie. Independent's duty to pay Stinky the $ 4.35 million purchase price for Love Stinks was unconditional--it was not contingent upon the film's success.

c. Inequity or Injustice to Stinky

This element does not require proof of actual fraud. (Associated, supra, 210 Cal. App. 2d at p. 838.) It is satisfied if treating the acts as being those of the corporation alone will produce inequitable results. (Stark v. Coker (1942) 20 Cal.2d 839, 846.)[*18] "All that is required is a showing that it would be unjust to persist in recognition of the separate entity of the corporation." (Claremont, supra, 187 Cal. App. 2d at p. 817.)

Independent convinced Stinky to enter the distribution agreement based on repeated assurances that Independent was well capitalized and had adequate financial resources from Lacy. Apart from verbal guarantees that Lacy had committed $ 30 million to Independent and personally guaranteed the debt to Stinky, Independent also provided Franklin with a "corporate overview" claiming that Independent was a "premier $ 85 million per annum" production company to which Lacy has committed $ 30 million in "seed capital." Independent's chief financial officer guaranteed payment to Franklin even if revenues from Love Stinks were inadequate, because private capitalization (i.e., Lacy) would make up any shortfall. (See Claremont, supra, 187 Cal. App. 2d at pp. 815-817 [a defendant who stated that he had good credit and was financially responsible for the success of the corporation was personally liable to the plaintiff on an alter ego theory, after he undercapitalized the operation]. See[*19] also Lyons v. Stevenson (1977) 65 Cal. App. 3d 595, 606-607, 135 Cal. Rptr. 457 [an inference could be drawn that the plaintiff entered an agreement with the

defendant in the belief that the defendant "regarded himself personally obligated to meet the terms of the agreement," allowing the trial court to pierce the corporate veil].)

Movie distribution is an enterprise that requires millions of dollars. Franklin was misled by Independent's claims of ample capitalization, backed by Lacy's personal guarantee of payment. At the time Stinky entered the renegotiated distributorship agreement with Independent, it seemed that Independent would easily be able to pay $ 8 million for prints and advertising, as well as for the $ 4.35 million purchase price, given the written and verbal assurances of Lacy's purported $ 30 million backing. Independent's assets were grossly inadequate to meet the commitment it made to Stinky.

It would be inequitable to allow Lacy to hide behind the corporate formality after using the strength of his personal backing to induce Stinky to deliver Love Stinks to Independent. In all likelihood, Independent would have had adequate funds to pay Stinky[*20] the $ 4.35 million purchase price if Lacy and his family had adequately funded Independent in the first place, then invested the company's assets conservatively rather than using them to pay off personal debts and to pay off obligations incurred by other Lacy companies.

Lacy argues that equity should not intervene in consensual commercial bargains. He assets that the alter ego doctrine should only apply in tort cases, where the victim is taken by surprise. Stinky, unlike a tort victim, had advance opportunity to find out whether Independent was adequately capitalized.

The case law does not support Lacy's theory that the alter ego doctrine applies only to tort cases. In many of the cases where the corporate veil was pierced, the underlying wrong was a breach of contract. For example, in one case the plaintiff agreed to print a corporation's weekly newspaper, then successfully sued under an alter ego theory when the corporation failed to pay the printing bill. (Claremont, supra, 187 Cal. App. 2d 813, 815-816.) In another case, the defendant was found to be the alter ego of an inadequately capitalized corporation that failed to pay for engineering work that the plaintiff[*21] contracted to perform. (Engineering etc. Corp. v. Longridge Inv. Co. (1957) 153 Cal. App. 2d 404, 411-412.) Three individuals were found personally liable for the debts of a corporation that owed money for cars it had purchased from the plaintiff. (Automotriz, supra, 47 Cal.2d at p. 794.) In short, a finding of alter ego is not limited to tort cases.

There is sufficient evidence to uphold the trial court's findings.

DISPOSITION

The judgment is affirmed.

BOREN, P.J.

We concur:

NOTT, J.

ASHMANN-GERST, J.

FILO AMERICA, INC., d/b/a F & F INDUSTRIES, Plaintiff, v. OLHOSS TRADING COMPANY, L.L.C.; STEVEN LAMAR FOWLER; and MARY CATHERINE SPANN, Defendants, v. ROBERT ALEXANDER, d/b/a B & G DISTRIBUTORS, Third-Party Defendant.

CIVIL ACTION NO. 1:04cv322-T

UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF ALABAMA, SOUTHERN DIVISION

321 F. Supp. 2d 1266; 2004 U.S. Dist. LEXIS 11406

June 22, 2004, Decided

DISPOSITION: [**1] Motion to dismiss, filed by defendants Steven Lamar Fowler and Mary Catherine Spann, treated as a Rule 15(c) motion for judgment on the pleadings, denied.

LexisNexis(R) Headnotes

COUNSEL: For FILO AMERICA, Inc. dba F & F Industries dba F & F Industries, Inc., Plaintiff: Joel Davidson Connally, Sasser Littleton & Stidham PC, Montgomery, AL. Stephen L. Joseph, Law Offices of Stephen L. Joseph, San Francisco, CA.

For Olhoss Trading Company, L.L.C., Steven Lamar Fowler, Catherine Spann, Defendants: Richard Martin Adams, Parkman & Associates, Dothan, AL.

JUDGES: Myron H. Thompson, UNITED STATES DISTRICT JUDGE.

OPINIONBY: Myron H. Thompson

OPINION:

[*1267] ORDER

Plaintiff FILO America, Inc. brought this lawsuit against defendants Olhoss Trading Company, LLC, Steven Lamar Fowler, and Mary Catherine Spann, alleging state-law claims of breach of contract, fraud, conversion, and deprivation of ownership. The diversity-of-citizenship jurisdiction of the court is properly invoked pursuant to *28 U.S.C.A. § 1332*. This case is now before the court on Fowler and Spann's *Fed. R. Civ. P. 12(b)(6)* motion to dismiss for failure to state a claim [**2] upon which relief can be granted. For the following reasons, this motion will be denied.

I. Procedural issues

First, the court must address some procedural issues raised by the dismissal motion. *Fed. R. Civ. P. 12(b)* states that "a motion making any of these defenses [including failure to state a claim upon which relief can be granted] shall be made before pleading if a further pleading is permitted." Fowler and Spann's *Rule 12(b)(6)* motion to dismiss for failure to state a claim was filed after they had filed an answer. n1 Once the answer was filed, the pleadings were closed, and a *Rule 12(b)(6)* motion to dismiss, which did not go to the jurisdiction of the court, was inappropriate. *Hallberg v. Pasco County, 1996 U.S. Dist. LEXIS 4161, 1996 WL 153673, at *2 (M.D. Fla. 1996)*. However, when a defendant files a *Rule 12(b)(6)* motion after filing an answer, a court can exercise its discretion and treat the motion [*1268] as a *Rule 12(c)* motion for judgment on the pleadings. Id.; *Summers v. Howard Univ., 127 F. Supp. 2d 27, 29 (D.D.C. 2000)*.

n1 Answer filed May 3, 2004 (Doc. no. 14); motion to dismiss filed May 3, 2004 (Doc. no. 15).

[**3]

Complicating matters further is the fact that Fowler and Spann filed a brief in support of their motion to

dismiss and attached to the brief was an affidavit. If, on either a *Rule 12(b)(6)* motion to dismiss for failure to state a claim or a *Rule 12(c)* motion for judgment on the pleadings, "matters outside the pleadings are presented to the court and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided by *Rule 56* [of the Federal of Civil Procedure]," with all parties given an opportunity to present evidence. *Fed. R. Civ. P. 12(b) & (c)*. Thus, the court must either ignore or exclude the affidavit or treat the motion as a motion for summary judgment.

The court will exercise its discretion to ignore the affidavit filed in support of Fowler and Spann's motion; then, for the reasons explained above, the court will treat the motion as a *Rule 12(c)* motion for judgment on the pleadings. n2

> n2 Of course, if Fowler and Spann wish to move for summary judgment and to resubmit this affidavit in support of that motion, they may do so.

[**4]

II. Merits of motion for judgment on the pleadings

"Judgment on the pleadings is appropriate when there are no material facts in dispute, and judgment may be rendered by considering the substance of the pleadings and any judicially noticed facts." *Hawthorne v. Mac Adjustment, Inc., 140 F.3d 1367, 1370 (11th Cir. 1998)*. Here, judgment on the pleadings is inappropriate because there are material facts in dispute.

Fowler and Spann argue that they should be dismissed from the case because they are members of co-defendant Olhoss Trading Company, a limited liability company, and Alabama law prohibits suits against a limited liability company, otherwise known as an LLC, from being brought against the members of the company. It is true that, in general, members of an LLC are not proper parties to proceedings against the LLC, 1975 *Ala. Code § 10-12-18*, and members are not liable for judgments against the LLC, 1975 *Ala. Code § 10-12-20*.

FILO America argues that Fowler and Spann's motion should be denied because it has made allegations which, if proved, would justify "piercing the LLC veil" of Olhoss. [**5] It is well-established in Alabama law that in some limited circumstances, a court can disregard a corporate entity, or "pierce the corporate veil," and impose liability directly on the stockholders or owners of a corporation. *Culp v. Economy Mobile Homes, Inc., So.2d , , 2004 Ala. LEXIS 60, 2004 WL 541818, at *2-3 (Ala. 2004)*.

However, here Fowler and Spann are not the owners or stockholders of a corporation, but rather are members of an LLC. FILO America does not cite, and the court does not find, any Alabama case addressing the question of whether the "veil" of an LLC can be "pierced" in the same way that a corporate "veil" can be "pierced." This may be due to the fact that LLCs are a relatively new legal form in Alabama, having been created by statute only in 1993. See Bradley J. Sklar and W. Todd Carlisle, The Alabama Limited Liability Company Act, *45 Ala. L. Rev. 145, 146 (1993)*.

However, this court is convinced that, under Alabama law, it is possible to "pierce the veil" of an LLC. n3 The LLC is a "hybrid form of business entity that, when [*1269] properly structured, combines the most desirable feature of a [**6] corporation (limited liability) with the income tax advantages of a partnership (pass-through treatment)." *Id. at 147*. Under Alabama's statutes, an LLC has the same kind of limited liability as does a corporation. 1975 *Ala. Code § 10-12-20* commentary ("The effect of this section is that a limited liability company will always have the corporate characteristic of limited liability"). Relatedly, "with respect to his liability for the debts and obligations of the limited liability company, a member is analogous to a limited partner or a stockholder." Id. Because the LLC borrows its limited liability characteristics from the law applicable to corporations, the "veil-piercing" exception applicable to corporations should also apply to LLCs. In other words, since a stockholder or owner of a corporation can be held liable for the debts and obligations of the corporation in the rare case in which "piercing the corporate veil" is appropriate, a member of an LLC should be similarly liable when it is appropriate for the "veil" of the LLC to be "pierced." See Sklar and Carlisle, *supra, at 200* (stating that corporate precedents on veil piercing [**7] will probably apply to LLCs in Alabama).

> n3 Of course, sitting in a diversity case, this court is making only an educated guess as to how the Alabama Supreme Court would rule on this issue.

The commentators who have discussed the issue as a nationwide matter have concluded that the "veil-piercing" doctrine applies to LLCs. Karin Schwindt, Comment, Limited Liability Companies: Issues in Member Liability, *44 U.C.L.A. L.Rev. 1541 (1997)*; Robert B. Thompson, The Limits of Liability in the New Limited Liability Entities, *32 Wake Forest L.Rev. 1 (1997)*; Rachel Maizes, *Limited Liability Companies: A Critique, 70 St. John's L.Rev. 575 (1996)*; Robert R.

Keatinge, et al., The Limited Liability Company: A Study of the Emerging Entity, *47 Bus. Law. 375, 445* (1992); Curtis J. Braukmann, Comment, *Limited Liability Companies, 39 Kan. L. Rev. 967, 992 (1991)*; Wayne M. Gazur & Neil M. Goff, Assessing the Limited Liability Company, [**8] *41 Case W. Res. L.Rev. 387, 403 (1991)*; Eric Fox, Note, Piercing the Veil of Limited Liability Companies, *62 Geo. Wash. L.Rev. 1143 (1994)*.

Further, the courts in other States that have considered whether the "veil-piercing" doctrine applies to LLCs have concluded that it does. *XL Vision, LLC. v. Holloway, 856 So.2d 1063, 1066 (Fla. App. 2003)*; *Tom Thumb Food Markets, Inc. v. TLH Properties, LLC, 1999 Minn. App. LEXIS 84, 1999 WL 31168, at *3 (Minn. App. 1999)* (unpublished opinion); *New Horizons Supply Coop. v. Haack, 224 Wis. 2d 644, 590 N.W.2d 282 (Wis. App. 1999)* (unpublished table opinion); *Bowen v. 707 On Main, 2004 Conn. Super. LEXIS 375, 2004 WL 424501, at *2 (Conn. Super. 2004)* (unpublished opinion); *Advanced Telephone Sys., Inc. v. Com-Net Professional Mobile Radio, LLC, 2004 PA Super 100, 846 A.2d 1264, 1281-82 (Pa. Super. 2004)*; see also *In re Crowe Rope Indus., LLC, 307 B.R. 1, 7 (Brktcy. D. Me. 2004)* (Maine law as predicted by bankruptcy court); *In re Sanner, 218 B.R. 941 (Bankr. D. Ariz. 1998)* (Arizona law as predicted by bankruptcy court); ***Hollowell v. Orleans Regional Hosp., 1998 U.S. Dist. LEXIS 8184, 1998 WL 283298,*** [**9] ***at *9 (E.D. La. 1998)*** (Louisiana law as predicted by federal district court); *Ditty v. CheckRite, Ltd., 973 F. Supp. 1320, 1335-36 (D.Utah 1997)* (Utah law as predicted by federal district court).

Therefore, this court concludes that, under Alabama law, it is possible to "pierce the veil" of an LLC in some situations. The factors that Alabama courts consider in deciding whether it is appropriate to "pierce the veil" of a corporation are: (1) inadequacy of capital; (2) fraudulent purpose in conception or operation of the business; (3) operation of the corporation as an instrumentality or alter ego. *Culp v. Economy Mobile Homes, Inc., So.2d , 2004 Ala. LEXIS 60, 2004 WL 541818 (Ala.)* (internal citations omitted). While some of these factors may not apply to LLCs in the same [*1270] way they apply to corporations, see Sklar and Carlisle, *supra, at 202* ("Inadequacy of capital should provide less of a basis for piercing the LLC veil than the corporate veil"), a fraudulent purpose in the conception or operation of an LLC should certainly be a valid reason for "piercing" the LLC's "veil." Eric Fox, Note, Piercing the Veil of Limited Liability Companies, [**10] *62 Geo. Wash. L.Rev. 1143 (1994)* ("If it is in the public interest to disregard the legal fiction when those benefitting from that fiction commit fraudulent conduct, it should not matter to the court whether the legal fiction is used by corporate shareholders or LLC members").

Here, FILO America has stated a claim adequate to pierce Olhoss's LLC "veil" by alleging that Fowler and Spann had a fraudulent purpose in the conception of their business. n4

n4 Complaint filed April 5, 2004 (Doc. no. 1), P28 ("Defendants Spann and Fowler formed Defendant Olhoss on December 30, 2003, to use as a vehicle to defraud Plaintiff and others").

III. Conclusion

For the foregoing reasons, it is ORDERED as follows:

(1) The affidavit of defendant Fowler, attached to the brief in support of the motion to dismiss, filed on June 1, 2004 (Doc. no. 25), is ignored.

(2) The motion to dismiss, filed by defendants Steven Lamar Fowler and Mary Catherine Spann Spann on May 3, 2004 (Doc. [**11] no. 15), is treated as a *Rule 15(c)* motion for judgment on the pleadings and is denied.

DONE, this the 22nd day of June, 2004.

/s/ Myron H. Thompson

UNITED STATES DISTRICT JUDGE

DANIEL NELSEN, Plaintiff, v. WALDO MORRIS, an individual, Defendant.

No. 03 C 7174

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

2004 U.S. Dist. LEXIS 6928

April 21, 2004, Decided
April 22, 2004, Docketed

DISPOSITION: [*1] Defendant's motion to dismiss pursuant to *Rule 12(b)(2)* denied.

LexisNexis(R) Headnotes

COUNSEL: For DANIEL NELSEN, plaintiff: Philip John Berenz, Law Offices of Philip J. Berenz, Chartered, Chicago, IL.

For WALDO MORRIS, an individual, defendant: Michael Denny Huber, Daniel K. Cray, Iwan Cray Huber Horstman & VanAusdal LLC, Chicago, IL.

JUDGES: WILLIAM T. HART, UNITED STATES DISTRICT JUDGE.

OPINIONBY: WILLIAM T. HART

OPINION:

MEMORANDUM OPINION AND ORDER

Plaintiff Daniel Nelsen, an Illinois resident, alleges that he lost money investing in limited liability companies ("LLC's") that leased aircraft. Plaintiff alleges that defendant Waldo Morris, an Iowa resident, caused these losses by breaching his fiduciary duty as a managing member of the LLC's and by committing fraud in order to induce plaintiff's investment. There is complete diversity of citizenship and the amount in controversy exceeds $ 75,000. Defendant has moved to dismiss based on lack of personal jurisdiction.

The burden is on plaintiff to show that personal jurisdiction over defendant is proper. *Purdue Research Foundation v. Sanofi-Synthelabo, S.A., 338 F.3d 773, 782 (7th Cir. 2003)*; *Steel Warehouse of Wisconsin, Inc. v. Leach, 154 F.3d 712, 714 (7th Cir. 1998)*; [*2] *Chen v. Quark Biotech, Inc., 2003 U.S. Dist. LEXIS 22780, 2003 WL 22995163 *1 (N.D. Ill. Dec. 15, 2003)*. For purposes of ruling on the question of personal jurisdiction, all uncontroverted facts alleged by plaintiff, all facts adequately supported by any affidavit or other evidence submitted by plaintiff, and all uncontroverted facts supported by defendant's affidavits or documentary submissions are assumed to be true. See *Purdue Research, 338 F.3d at 782-83*; *McIlwee v. ADM Industries, Inc., 17 F.3d 222, 223 (7th Cir. 1994)*; *Weidner Communications, Inc. v. H.R.H. Prince Bandar Al Faisal, 859 F.2d 1302, 1306 n.7 (7th Cir. 1988)*; *Turnock v. Cope, 816 F.2d 332, 333 (7th Cir. 1987)*. The parties were permitted to engage in discovery prior to completing briefing on defendant's motion. However, since the ruling on personal jurisdiction is being made on written submissions, not following an evidentiary hearing, plaintiff is only required to make a prima facie showing in support of his claimed basis for personal jurisdiction. *Purdue Research, 338 F.3d at 782-83*.

According to the allegations of the complaint, defendant [*3] was the managing member of two LLC's known as Interlease IV and Interlease V. Both LLC's were in the business of leasing aircraft that were owned by the LLC's. Plaintiff was a 25% member of Interlease IV and a 5% member of Interlease V. Plaintiff allegedly loaned Interlease V $ 1,000,000 in return for a promissory note secured by an aircraft, but later relinquished the note for his 5% share of Interlease V. Plaintiff allegedly invested another $ 1,000,000 and also personally guaranteed a $ 5,800,000 loan as part of his purchase price for his interest in Interlease IV. Defendant allegedly used the loan proceeds to pay off debts

defendant would have otherwise owed. Also, defendant allegedly intermingled funds among various LLC's and used some funds for his own benefit. After the foreclosure on the loan, defendant allegedly improperly purchased one of the aircraft that had been security. Plaintiff lost his $ 2,000,000 investment and, based on the personal guaranty, was required to pay $ 1,451,250 in principal plus $ 92,940 interest and incurred $ 46,060 in attorney fees.

In response to defendant's pending motion, plaintiff does not contend that defendant directly solicited the investments [*4] from him. Instead, plaintiff contends that the LLC's themselves were based in Illinois and that defendant conducted his business through the LLC's and through an agent, Phil Coleman, who was the one who directly solicited plaintiff. Defendant does not dispute that the LLC's are based in Illinois n1 and that the LLC's themselves engaged in conduct that would be a basis for personal jurisdiction in Illinois. Defendant does not provide evidence disputing the allegations of the complaint that he commingled funds among the various LLC's or that he used assets for his personal benefit. n2 Therefore, these allegations must be taken as true for purposes of ruling on the motion to dismiss. Plaintiff provides evidence supporting that defendant participated in managing and directing the activities of the LLC's.

n1 Although operating in Illinois, the LLC's are organized under the laws of Iowa.

n2 On a personal jurisdiction motion, the substantive allegations of the complaint are generally taken as true. See *Chen, 2003 U.S. Dist. LEXIS 22780, 2003 WL 22995163 at *5 n.4.*

[*5]

Since there is no dispute regarding the activity of the LLC's being a basis for exercising jurisdiction in Illinois, it is unnecessary to detail the general rules regarding exercising personal jurisdiction. See generally *Hyatt International Corp. v. Coco, 302 F.3d 707, 713-17 (7th Cir. 2002)*; *YKK USA, Inc. v. Baron, 976 F. Supp. 743, 745-47 (N.D. Ill. 1997)*. The LLC's were doing business in Illinois, which would subject them to general jurisdiction in Illinois, even as to cases that do not arise from the particular contacts in Illinois. See *Hyatt, 302 F.3d at 713*. To the extent the conduct of the LLC's is attributable to defendant, he would also be amenable to suit in Illinois on any claim. Under the "fiduciary shield" doctrine, however, an individual's acts performed in a representative capacity generally will not be a basis for exercising jurisdiction over the individual. *YKK, 976 F. Supp. at 747*. One exception to the fiduciary shield doctrine, however, is the "sham" or "alter ego" exception. "This exception is applicable 'where the plaintiff seeks to pierce the corporate veil by alleging that the corporation was [*6] a mere shell utilized by the individual defendant for his own personal benefit.'" *Id.* (quoting *Torco Oil Co. v. Innovative Thermal Corp., 730 F. Supp. 126, 135-136 (N.D. Ill. 1989)*). "If the 'alter ego' exception is applicable, the corporation's contacts are attributed to the individual for the purposes of personal jurisdiction determination." *Id.*

Defendant contends that plaintiff cannot rely on this theory because no alter ego, sham, or corporate piercing allegations are contained in the complaint. The complaint only contains allegations of direct liability on defendant's part. However, here plaintiff is relying on general jurisdiction. The basis for exercising personal jurisdiction, therefore, need not be the same as the breach of fiduciary duty and fraud claims contained in the complaint. Additionally, although the alter ego exception to the fiduciary shield doctrine and piercing the corporate veil for liability purposes are similar concepts, they have differing elements and distinct purposes. See *YKK, 976 F. Supp. at 747*; *Torco, 730 F. Supp. at 136*. Plaintiff may raise the alter ego doctrine even though he has not alleged [*7] a piercing the corporate veil allegation in his complaint.

In response to the motion to dismiss, plaintiff need only make a "minimally viable" showing that the LLC's are a sham. *YKK, 976 F. Supp. at 747* (quoting *Torco, 730 F. Supp. at 136*). It is enough to show that the allegations are not "patently without merit." *Torco, 730 F. Supp. at 136*; *Van Ru Credit Corp. v. Professional Brokerage Consultants, Inc., 2003 U.S. Dist. LEXIS 19292, 2003 WL 22462607 *2 (N.D. Ill. Oct. 29, 2003)*. The alter ego rules applicable to LLC's are generally the same as those for corporations. See *Iowa Code § 490A.603(2)* (personal liability of LLC member is same as that of a corporate shareholder except that failure to observe formalities as to meetings is not a consideration). See also *Kaycee Land & Livestock v. Flahive, 2002 WY 73, 46 P.3d 323, 327-28 (Wyo. 2002)*; *Hollowell v. Orleans Regional Hospital LLC, 217 F.3d 379, 385 (5th Cir. 2000)*. Here, it must be taken as true that funds of the various LLC's were commingled, that Interlease IV became insolvent in that the guarantors had to pay off the outstanding [*8] balance of its loan, and that defendant used LLC funds for his own benefit. There is also evidence that defendant managed and/or directed activities of the LLC's. It cannot be held that plaintiff's alter ego theory is not viable. Cf. *Torco, 730 F. Supp. at 137-39*. Therefore, the conduct of the LLC's is attributable to defendant for personal jurisdiction purposes and, at this stage of the proceedings, it is appropriate to continue to exercise personal jurisdiction over defendant. Because personal jurisdiction is being

upheld on this basis, it is unnecessary to consider whether the fiduciary shield doctrine should not apply because defendant was acting in his own interest instead of the interests of the LLC's and whether, on that basis, it would be appropriate to exercise general and/or specific personal jurisdiction.

IT IS THEREFORE ORDERED that defendant's motion to dismiss pursuant to *Rule 12(b)(2)* [4-1] is denied. Within 10 days, defendant shall answer the complaint. All discovery is to be completed by August 3, 2004. A status hearing will be held on May 12, 2004 at 11:00 a.m.

WILLIAM T. HART

UNITED STATES DISTRICT JUDGE

DATED: [*9] APRIL 21, 2004

78 of 196 DOCUMENTS

In re: MIDPOINT DEVELOPMENT, L.L.C., Debtor(s).

No. 04-16795-BH, Chapter 11

UNITED STATES BANKRUPTCY COURT FOR THE WESTERN DISTRICT OF OKLAHOMA

313 B.R. 486; 2004 Bankr. LEXIS 1244; 43 Bankr. Ct. Dec. 143

August 19, 2004, Decided
August 19, 2004, Filed

DISPOSITION: [**1] Creditors' motion to dismiss petition denied.

LexisNexis(R) Headnotes

COUNSEL: FOR GARY WEST, TRUSTEE OF THE 1990 GRIESER TRUST, CREDITOR-MOVANT: Douglas N. Gould, Oklahoma City, Oklahoma.

FOR CLAUDIA HOLLIMAN, CREDITOR-MOVANT: Jimmy K. Goodman, William H. Hoch, Reagan D. Allen, Crowe & Dunlevy, P.C., Oklahoma City, Oklahoma.

FOR MIDPOINT DEVELOPMENT, DEBTOR-RESPONDENT: Michael Paul Kirschner, Lorrie A. Corbin, Kirschner Law Firm, Oklahoma City, Oklahoma.

Bobbie G. Bayless, Bayless & Stokes, Houston, Texas.

JUDGES: Richard L. Bohanon, United States Bankruptcy Judge.

OPINIONBY: Richard L. Bohanon

OPINION:

[*486] **ORDER DENYING JOINT MOTION TO DISMISS PETITION**

For the reasons set forth below, the Court hereby denies the joint motion to dismiss the petition asserting that the Debtor is ineligible to be a debtor under the Bankruptcy Code.

Background

Creditors Claudia Holliman and Gary West, Trustee of the 1990 Grieser Trust, ("the Movants") jointly seek dismissal of the Debtor's Chapter 11 petition, and the [*487] Debtor opposes the motion. At a hearing, the Court denied the portion of the motion seeking dismissal of the petition for cause and took under submission the portion concerning whether the Debtor is eligible [**2] to be a debtor under the Bankruptcy Code.

The Debtor along with several other related entities were previously debtors under Chapter 11; however, those petitions were dismissed in November 2003 following protracted proceedings. Shortly thereafter, on November 14, 2003, the Debtor filed articles of dissolution with the Oklahoma Secretary of State. Later, the Debtor filed this Chapter 11 petition, and the Movants moved to dismiss the petition.

The Court concludes that the Debtor is eligible to be a debtor and denies the remaining part of the motion to dismiss.

Discussion

The issue is whether a dissolved Oklahoma limited liability company is eligible to be a debtor under Chapter 11 of the Bankruptcy Code. There are no cases answering this question, and in order to discover an answer, the Court considers the statutory construction of the *Oklahoma Limited Liability Company Act* as well as related jurisprudence.

The Movants assert that the plain language of the Limited Liability Company Act mandates that the Debtor's existence terminated upon its dissolution. They point out that applicable sections of the *Oklahoma General Corporation Act* and the *Oklahoma Revised*

Uniform Partnership Act [**3] provide for the continued existence of a corporation or partnership upon dissolution in order to wind up affairs. n1 See e.g., *18 Okla. Stat. Ann. § 1099*; *54 Okla. Stat. Ann. § 1-802(a)*. On the other hand, the Act has no such express provision. Thus, the Movants argue that the common law rule that "a corporation which has been dissolved is as if it did not exist" applies. *Oklahoma Natural Gas Co. v. Oklahoma, 273 U.S. 257, 259, 71 L. Ed. 634, 47 S. Ct. 391 (1927)*. Therefore, according to the Movants, the Debtor ceased to exist upon its dissolution and cannot be a debtor under the Bankruptcy Code.

n1 Those sections do expressly provide for the continuation of a corporation or partnership for winding up affairs. Those sections provide:

> All corporations, whether they expire by their own limitation or are otherwise dissolved, nevertheless shall be continued, for the term of three (3) years from such expiration or dissolution or for such longer period as the district court shall in its discretion direct ...

18 Okla. Stat. Ann. § 1099; and

> (a) Subject to subsection (b) of this section, a partnership continues after dissolution only for the purpose of winding up its business. The partnership is terminated when the winding up of its business is completed.

54 Okla. Stat. Ann. § 1-802(a).

[**4]

However, the analysis is not so simple. To be eligible to be a debtor under the Bankruptcy Code, an entity must be a "person." See *11 U.S.C. § 109(a)*. "Person" is defined at *11 U.S.C. § 101(41)* to include an "individual, partnership, and corporation." In turn, "corporation" is defined as follows:

> (9) "corporation"--
> (A) includes--
>
> (i) association having a power or privilege that a private corporation, but not an individual or a partnership, possesses;
>
> (ii) partnership association organized under a law that makes only the capital subscribed responsible for the debts of such association;
>
> (iii) joint-stock company;
>
> (iv) unincorporated company or association; or
>
> (v) business trust; but [*488] (B) does not include limited partnership.

11 U.S.C. § 101(9). Moreover, "includes" is not limiting, see *11 U.S.C. § 102(3)*, meaning that this list is not exhaustive.

Even though the Bankruptcy Code does not explicitly mention limited liability companies, most commentators agree that they are sufficiently analogous to corporations and partnerships to be debtors. See *In re ICLNDS Notes Acquisition, L.L.C., 259 B.R. 289, 293 (Bankr. N.D. Ohio 2001)*. [**5] See also, Thomas F. Blakemore, Limited Liability Companies and the Bankruptcy Code: a Technical Review, 13 Am. Bankr. Inst. J. 12 (June 1994) (noting that a limited liability company appears to qualify as a "corporation"); Steven A. Waters & Eric Terry, Bankruptcy and Insolvency Issues for Partnerships, LLCs, and Their Owners--the Good, the Bad, and the Ugly, 39 Tex. J. Bus. L. 51, 79 (Spring 2003) (observing that "corporation" fits a limited liability company). Of course, the Movants do not dispute that limited liability companies in general are eligible to be debtors, but rather the issue is whether a dissolved limited liability company is eligible to be a debtor.

This requires a solicitous consideration of the Act. See generally, *18 Okla. Stat. Ann. § 2000 et seq.* A review of it shows that the status of a dissolved limited liability company is less than clear. Nonetheless, reading the Act as a whole implies that, contrary to the Movants' argument, a dissolved limited liability company does not cease to exist upon dissolution, but rather it continues in order to wind up affairs.

First, some sections of the Act refer to "winding up" affairs in connection with [**6] dissolution. For instance, *§ 2012.1(A) of the Act* provides that "the articles of organization shall be canceled upon the dissolution and the completion of winding up of a limited liability company ...." *18 Okla. Stat. Ann. § 2012.1(A)* (emphasis added). From the statute, it is unclear what "canceled" means, but the important key here is that the statute provides for cancellation of the articles of organization only when there has been both dissolution and completion of winding up.

Also, *§ 2039 of the Act* governs the manner in which the affairs of a limited liability company may be wound up. *Section 2039(A)(2)* allows for those managers winding up affairs to:

> a. prosecute and defend suits,
> b. settle and close the business of the limited liability company,
> c. dispose of and transfer the property of the limited liability company,
> d. discharge the liabilities of the limited liability company, and
> e. distribute to the members any remaining assets of the limited liability company.

18 Okla. Stat. Ann. § 2039(A)(2). That section further provides that a manager can bind a limited liability company after an event causing dissolution. That portion of the statute [**7] reads as follows:

> After an event causing dissolution, of the limited liability company any manager can bind the limited liability company:
>
> 1. By any act appropriate for winding up the limited liability company's affairs or completing transactions unfinished at dissolution; and
>
> 2. By any transaction that would have bound the limited liability company if it had not been dissolved, if the other party to the transaction does not have notice of the dissolution.

18 Okla. Stat. Ann. § 2039(B).

Thus, a fair reading of the Act is that dissolved limited liability companies are empowered to wind up their affairs, and they therefore must continue to exist [*489] in a legal sense for this to be carried out. It thus follows that a dissolved limited liability company qualifies as a debtor in order to wind up its affairs.

Indeed, courts have permitted dissolved corporations to be debtors. See *Cedar Tide Corp. v. Chandler's Cove Inn, Ltd. (In re Cedar Tide Corp.), 859 F.2d 1127, 1131-32 (2d Cir. 1988)* (citing *New Haven Radio, Inc. v. Meister (In re Martin-Trigona), 760 F.2d 1334 (2d Cir. 1995))*. In Cedar Tide, the debtor was dissolved by New [**8] York for failure to pay taxes, but it later sought Chapter 11 bankruptcy protection. The Court of Appeals for the Second Circuit held that the bankruptcy court did have subject matter jurisdiction over a dissolved corporate debtor. See id.

Given the acknowledged similarities between corporations and limited liability companies, there is no reason that a dissolved limited liability company is ineligible to be a debtor under the Bankruptcy Code. Despite the dearth of case law on this issue, at least two commentators agree with the Court's analysis when they write:

> As noted above, the LLC entity is too new to be covered by current or former bankruptcy statutes. By analogy to partnerships, it is not unreasonable to predict that the same analysis would apply--until winding up has been completed and articles of dissolution filed with the Secretary of State, an LLC should continue to be subject to bankruptcy filing.

Waters & Terry, supra, at 79. The Court concludes that a dissolved Oklahoma limited liability company is eligible to be a debtor under the Bankruptcy Code under these circumstances.

Conclusion

Accordingly, the Court hereby denies the portion [**9] of the joint motion to dismiss the petition asserting that the Debtor is ineligible to be a debtor.

Dated: August 19, 2004

By the court

Richard L. Bohanon

United States Bankruptcy Judge

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Suzy Strickland Harbison v. Bonnie Sue Strickland

1030591

SUPREME COURT OF ALABAMA

2004 Ala. LEXIS 275

October 22, 2004, Released

NOTICE: [*1] THIS OPINION IS SUBJECT TO CORRECTION OR REVISION BEFORE PUBLICATION IN THE OFFICIAL REPORTER.

PRIOR HISTORY: Appeal from Elmore Circuit Court. CV-03-9.

DISPOSITION: Reversed and remanded.

LexisNexis(R) Headnotes

JUDGES: SEE, Justice. Nabers, C.J., and Johnstone, Harwood, and Stuart, JJ., concur.

OPINIONBY: SEE

OPINION: SEE, Justice.

Suzy Strickland Harbison appeals from a summary judgment in favor of the defendant, Bonnie Sue Strickland. We reverse and remand.

I.

Bonnie Sue Strickland is the manager and a 17% equity owner of the Strickland Family Limited Liability Company ("the LLC"). The LLC was formed by Bonnie Sue Strickland and her now deceased husband, Jake Strickland, on August 4, 2000, as part of their estate plan. n1 The LLC was formed under the Alabama Limited Liability Company Act, *§ 10-12-1 et seq., Ala. Code 1975* ("ALLCA").

n1 The estate plan also included a will and various trust instruments, none of which are relevant to the present case.

In accordance with their estate plan, the Stricklands, on December 24, 2000, transferred [*2] 83% of the equity shares of the LLC to their daughter Suzy Strickland Harbison. n2 The Stricklands retained a 17% interest in the LLC and acted as comanagers of the LLC for the next two years.

n2 After this dispute arose, Bonnie Sue Strickland testified that neither she nor her deceased husband had actually intended to transfer such a large portion of the shares of the LLC to Harbison. However, the Stricklands' tax attorney had sent them letters explaining the transaction. Further, Bonnie Sue Strickland testified that she signed the assignment to Harbison on December 24, 2000. The assignment expressly provided that "the managers hereby consent to the foregoing assignment of [the shares of the LLC] to [Harbison]." The assignment also provided that "Bonnie Sue Strickland hereby assigns, transfers, and sets over all of her right, title and interest in [the LLC] to [Harbison]. "[A] person who signs a contract is on notice of the terms therein and is bound thereby, even if he or she fails to read the document." *Locklear Dodge City, Inc. v. Kimbrell, 703 So. 2d 303, 306 (Ala. 1997).*

[*3]

On January 17, 2002, Jake Strickland died. Under the operating agreement for the LLC, Bonnie Sue Strickland became the sole manager of the LLC and retained the 17% equity in the LLC she had held in

common with Jake. Harbison retained 83% of the equity shares in the LLC.

On December 24, 2002, Strickland conveyed three parcels of real property belonging to the LLC to her son David Strickland. David is not a member of the LLC. Strickland transferred the parcels of real property for an amount Harbison believes was less than fair market value. Harbison sued Strickland, claiming that Strickland had breached her fiduciary duty to the LLC under the ALLCA and that she had violated the terms of the operating agreement when she failed to make managerial decisions based on the best interests of the LLC and the equity owners.

Strickland moved for a summary judgment. After a hearing, the trial court entered a summary judgment in favor of Strickland, stating in pertinent part:

"This Court must look to the four corners of the governing document in determining whether the defendant breached her fiduciary duty to the LLC in selling LLC property to her son. In the present case the governing document [*4] is the operating agreement of the Strickland Family, LLC. In interpreting the LLC operating agreement this Court finds that Defendant did not breach her fiduciary duty to the LLC when Defendant sold LLC property to David. ...

"In interpreting the intent of the operating agreement through a four corners interpretation, this Court finds that the purpose of the LLC operating agreement was for distribution of the assets of the Defendant and Jake Strickland. This Court takes these purposes into account when in [sic] determining fiduciary duty. The Plaintiff applies a fiduciary standard as would be applicable to a for-profit business. However, the operating agreement clearly states that this LLC is not for profit:

"'The managers do not, in any way guarantee ... a profit for the Equity Owners from the operations of the Company. Decisions with respect to the conduct, dissolution and winding up of the business of the company shall be made in the sole discretion of the Equity Owners and such other matters as the Managers consider relevant. There shall be no obligation on the part of the Managers to maximize financial gain or to make any or all of the Company Property productive.' Strickland [*5] Family LLC Operating Agreement, Article VI, Section 6.4.1" n3

> n3 The trial court's order omits significant language from the middle sentence quoted above from the operating agreement. That sentence of Article VI, Section 6.4.1, of the operating agreement reads as follows:
>
> "Decisions with respect to the conduct, dissolution and winding up of the business of the Company shall be made in the sole discretion of the Managers based on the best interest of the Company, the best interests of the Equity Owners, and such other matters as the Managers consider relevant."
>
> (Omitted language emphasized.)

The trial court further ruled that because the LLC was ostensibly created for a nonprofit purpose, namely, for the distribution of LLC property to the Stricklands' children, Strickland was free to distribute the real property of the LLC as she saw fit. The trial court stated:

"Plaintiff argues that the property should have been sold at fair market value based on the most recent appraisal. However, [*6] in accordance with the operating agreement defendant had authorization to dispose of the property in anyway she saw fit. This included disposing of the property by gift. ... Whether Defendant sold the LLC assets for $ 1.00 or $ 1,000,000, or decided to give the property away, Defendant had authority to do so in her capacity as manager of the LLC."

II.

"We review a trial court's summary judgment de novo, giving the judgment no presumption of correctness." *Baldwin v. Branch, [Ms. 1011214, March 5, 2004] __ So. 2d __, 2004 Ala. LEXIS 38 (Ala. 2004)* (citing *Nationwide Ins. Co. v. Rhodes, 870 So. 2d 695, 696 (Ala. 2003))*. A summary judgment is proper when there is "no genuine issue as to any material fact and ... the moving party is entitled to a judgment as a matter of law." Rule 56, Ala. R. Civ. P.; *Ex parte Atmore Cmty. Hosp., 719 So. 2d 1190, 1193 (Ala. 1998)*; *Booker v. United American Ins. Co., 700 So. 2d 1333, 1334 (Ala. 1997)*. Because our resolution of this appeal turns on purely legal questions, we need not at this point determine the factual issues, if any.

Harbison argues that the trial court erred in referring only to the four corners [*7] of the document in interpreting the operating agreement. Harbison contends that the ALLCA imposes upon members and managers of limited liability companies fiduciary duties that cannot be eliminated by the adoption of an operating agreement. Thus, Harbison argues, by failing to incorporate the fiduciary duties mandated by the ALLCA into the operating agreement, the trial court has committed reversible error. This is an issue of first impression in this State.

It is well-settled in Alabama that a corporation is a "creature of statute." *Baldwin County Elec. Membership Corp. v. Lee, 804 So. 2d 1087, 1090 (Ala. 2001)*(quoting 1 Charles Keating & Gail O'Gradney, Fletcher Cyclopedia of the Law of Private Corporations § 3635 at 226 (1990)). A "corporation is ... subject to valid, appropriate measures of control, surveillance, and regulation government may impose ...." *Fairhope Single Tax Corp. v. Melville, 193 Ala. 289, 305, 69 So. 466, 471 (1915)*. "The charter of a corporation consists of its articles of incorporation taken in connection with the law under which it was organized ...." *State ex rel. Carter v. Harris, 273 Ala. 374, 376, 141 So. 2d 175, 176 (1961)*. [*8] "Provisions governing corporate operations include not only a corporation's articles of incorporation and bylaws, but also relevant sections of the statutory scheme under which the corporation exists." *Baldwin County Elec. Membership Corp., 804 So. 2d at 1090*. Additionally, "where the articles of incorporation or the bylaws conflict with the statute, the statute controls." Id.

The Legislature has imposed on corporations and partnerships fiduciary duties that cannot be waived. n4 In *Brooks v. Hill, 717 So. 2d 759, 764 (Ala. 1998)*, we stated: "'The statute *[§ 10-2A-71, Ala. Code 1975]* constitutes a more specific statutory expression of the general fiduciary duty owed by the directors and officers to shareholders under the *Alabama Business Corporation Act*.'" (Quoting *Fulton v. Callahan, 621 So. 2d 1235, 1246-47 (Ala. 1993)*(emphasis omitted).) We have similarly held that partners are bound by the fiduciary duties provided by statute. *Cox v. F&S, 489 So. 2d 516, 518 (Ala. 1986)*.

N4 See *§ 10-2B-2.02, Ala. Code 1975*, allowing the corporate charter to include a clause limiting the liability of directors, except liability for

"(A) the amount of a financial benefit received by a director to which he or she is not entitled; (B) an intentional infliction of harm on the corporation or the shareholders; (C) a violation of Section 10- 2B-8.33; (D) an intentional violation of criminal law; or (E) a breach of the director's duty of loyalty to the corporation or its shareholders."

See also *§ 10-8A-103, Ala. Code 1975*, discussing the effect of the partnership agreement on fiduciary duties:

"(b) The partnership agreement may not:

"...

"(3) eliminate the duty of loyalty ...

"...

"(4) unreasonably reduce the duty of care ...."

[*9]

Like corporations and limited partnerships, limited liability companies are creatures of statute. *§ § 10-12-1 to 10-12-61, Ala. Code 1975*; see also *McGee v. Best, 106 S.W.3d 48, 57 (Tenn. Ct. App. 2002)*("An LLC is a creature of statute, and any duty which members owe must be set forth in the statute."). Therefore, in interpreting an operating agreement for a limited liability company, the Court must look to the ALLCA.

In 1997 the Legislature added *subsections (e) through (l) to § 10-12-21, Ala. Code 1975*, a part of the ALLCA. Those subsections provide that a member owes a duty of loyalty to the LLC. n5

n5 "(e)In a limited liability company managed by its members under subsection (a) of Section 10-12-22, the only fiduciary duties a member owes to the company or to its other members are the duty of loyalty and the duty of care imposed by subsections (f) through (g).

"(f) A member's duty of loyalty to a member-managed limited liability company and its members is limited to each of the following:

"(1) To account to the limited liability company and to hold as trustee for it any property, profit, or benefit derived by the member in the conduct or winding up of the limited liability company's business or derived from a use by the member of the limited liability company's property, including the appropriation of the limited liability company's opportunity.

"(2) To refrain from dealing with the limited liability company in the conduct or winding up of the limited liability company's business as or on behalf of a party having an interest adverse to the limited liability company.

"(3) To refrain from competing with the limited liability company in the conduct of the limited liability company's business before the dissolution of the limited liability company.

"(g) A member's duty of care to a member-managed limited liability company and its other members in the conduct or winding up of the limited liability company's business is limited to refraining from engaging in grossly negligent or

reckless conduct, intentional misconduct, or a knowing violation of the law.

"(h) A member shall discharge the duties to a member- managed company and its other members under this chapter or under the operating agreement and exercise any rights consistently with the obligation of good faith and fair dealing.

"(i) A member of a member-managed company does not violate a duty or obligation under this chapter or under the operating agreement merely because the member's conduct furthers the member's own interest."

[*10]

Section 10-12-21, Ala. Code 1975, imposes these same duties on managers, n6 plus

n6 "(k) If the management of a limited liability company is vested in a manager or managers pursuant to subsection (b) of Section 10-12-22, each of the following applies:

"(1) The only duty a member who is not also a manager owes to the company or to the other members solely by reason of being a member is to not disclose or otherwise use information described in subsection (b) of Section 10-12-16, whether or not obtained under the authority of subsection (b) of Section 10-12-16, to the detriment of the company or the other members.

"(2) A manager is held to the same standards prescribed for members in subsection (f) through (i).

"(3) A member who pursuant to the operating agreement exercises some or all of the rights of a manager in the management and conduct of the company's business is held to the standards of conduct in subsections (f) through (i) to the extent that the member exercises the managerial authority vested in a manager by this chapter.

"(4) A manager is relieved of liability by law for violation of the standards prescribed by subsections (f) through (i) to the extent of the managerial authority delegated by the operating agreement."

[*11]

the following additional burdens:

"(l)The articles of organization or operating agreement may modify the duties contained in subsections (e) through (k) but may not provide for the following:

"(1) Unreasonably restrict a right to information or access to records under Section 10-12-16;

"(2) Eliminate the duty of loyalty under subsection (f) or subsection (e) of 10-12-36 ...;

"(3) Unreasonably reduce the duty of care under subsection (g) or subsection (e) of *Section 10-12-36*;

"(4) Eliminate the obligation of good faith and fair dealing under subsection (h), but the operating agreement may determine the standards by which the performance of the obligation is to be measured, if the standards are not manifestly unreasonable."

Thus, the plain language of *§ 10-12-21(l), Ala. Code 1975*, does not allow an operating agreement for a limited liability company to unreasonably restrict a member's right to information, to eliminate a manager's duty of loyalty, or to unreasonably reduce the duty of care as defined in *§ 10- 12-36, Ala. Code 1975*. n7 We hold that operating agreements of limited liability companies, like those of corporations and limited partnerships, incorporate the [*12] provisions of the statutes that allow for the creation of such agreements. Thus, the trial court erred in failing to look past the "four corners" of the document to determine Strickland's fiduciary obligations, if any, to the LLC and its members. On remand the trial court is to determine whether Strickland breached the fiduciary duties imposed on her by the ALLCA.

n7 The "Reporter's Comments as amended by Act 97-920" following *§ 10-12-21(l), Ala. Code 1975*, provide further clarification: "The added rules are based on the fiduciary rules contained in the Uniform Limited Liability Company Act(1995) ... § 409 ." The comment to § 409 of the Uniform Limited Liability Company Act (1996) provides:

"An operating agreement may not waive or eliminate the duties or obligation, but may, if not manifestly unreasonable, identify activities and determine standards for measuring the performance of them."

III.

Harbison also argues that the trial court erroneously concluded that it was within Strickland's authority [*13]

under the operating agreement to "dispose of the [LLC] property in any way she saw fit," because the LLC is "not for profit." The trial court's interpretation of the operating agreement depends on its finding that the purpose of the LLC was to distribute the Stricklands' assets. The trial court apparently relied on Strickland's testimony that, regardless of what the operating agreement actually provided, her "intent was to give their two children David Strickland ... and the Plaintiff, Suzy Strickland Harbison, each one-half of what was left of their estate assets."

Operating agreements of limited liability companies serve as contracts that set forth the rights, duties, and relationships of the parties to the agreement. See *Love v. Fleetway Air Freight & Delivery Serv., L.L.C., 875 So. 2d 285 (Ala. 2003)*. "It is elementary that it is the terms of the written contract, not the mental operations of one of the parties, that control its interpretation." *Kinmon v. J.P. King Auction Co., 290 Ala. 323, 325, 276 So. 2d 569, 570 (1973)*(citing *Todd v. Devaney, 265 Ala. 486, 92 So. 2d 24 (1957))*. "Stated another way, the law of contracts [*14] is premised upon an objective rather than a subjective manifestation of intent approach." *Lilley v. Gonzales, 417 So. 2d 161, 163 (Ala. 1982)*. "'[A] court should give the terms of the agreement their clear and plain meaning and should presume that the parties intended what the terms of the agreement clearly state." *Turner v. West Ridge Apartments, Inc., [Ms. 1030441, May 14, 2004] __ So. 2d __, 2004 Ala. LEXIS 124 (Ala. 2004)*(quoting *Ex parte Dan Tucker Auto Sales, Inc., 718 So. 2d 33, 36 (Ala. 1998))*.

Article III of the operating agreement clearly states that "the company is organized to make a profit, increase wealth and provide a means for the Equity Owners to become knowledgeable of, manage and preserve the Company Property."

This language indicates that the trial court's ruling suggesting that the LLC was meant to serve as a "nonprofit" vehicle and that Strickland could therefore dispose of the property as she wished is not supported by the terms of the operating agreement. Indeed, the very provision that the trial court relies upon to support its ruling -- Article VI, Section 6.4.1 -- authorizes the manager of the LLC to make business decisions for [*15] the LLC, "based on the best interest of the LLC, [and] the best interests of the Equity Owners." Article VI, Section 6.3.3, further provides:

"Notwithstanding any other provisions of this section 6.3 to the contrary, neither the Managers nor any Member or Members shall have the authority to amend this Operating Agreement or take any action that would have a Material Adverse Effect on a similarly situated group of Equity Owners ... without the consent of Equity Owners ...."

The trial court's finding that Strickland could dispose of the property of the LLC as she saw fit is irreconcilable with the language of the operating agreement that requires Strickland to consider the best interests of the LLC and the other equity owner, Harbison, before making any business decisions regarding the LLC. Strickland has not produced evidence indicating that she considered the interests of the LLC before she sold the real property. On remand, the trial court is to determine whether Strickland violated her duties as manager of the LLC, under the plain language of the operating agreement.

IV.

The summary judgment is reversed and the case remanded for proceedings consistent with this [*16] opinion.

REVERSED AND REMANDED.

Nabers, C.J., and Johnstone, Harwood, and Stuart, JJ., concur.

Dennis J. Gelinas et al. v. David A. Fuss et al.

CV030070629

SUPERIOR COURT OF CONNECTICUT, JUDICIAL DISTRICT OF WINDHAM, AT PUTNAM

2004 Conn. Super. LEXIS 731

March 18, 2004, Decided
March 19, 2004, Filed

NOTICE: [*1] THIS DECISION IS UNREPORTED AND MAY BE SUBJECT TO FURTHER APPELLATE REVIEW. COUNSEL IS CAUTIONED TO MAKE AN INDEPENDENT DETERMINATION OF THE STATUS OF THIS CASE.

LexisNexis(R) Headnotes

JUDGES: Foley, J.

OPINIONBY: Foley, J.

OPINION:

MEMORANDUM OF DECISION RE DEFENDANT DAVID A. FUSS'S MOTION FOR SUMMARY JUDGMENT # 108

The present lawsuit was brought against EarthFirst of New England, LLC and its sole member David A. Fuss. The complaint alleges breach of contract and negligence. The motion before the court is David A. Fuss's motion for summary judgment.

Specifically, the suit against Fuss questions the extent to which the sole member of a limited liability company can be held personally responsible 1) for the contracts of the company and 2) for his own negligent acts while working on behalf of the company. The court holds that he may not be held personally liable for the contracts of the limited liability company but may be liable for his own acts of negligence.

FACTS:

The plaintiff, Dennis Gelinas, executed two home improvement contracts with EarthFirst of New England, LLC, David A. Fuss, member. EarthFirst of New England, LLC, a registered limited liability company in Connecticut, changed its name in August 2002 [*2] and is now known as EarthFirst Excavation, LLC. Furthermore, EarthFirst Excavation, LLC is a licensed new home construction contractor and licensed home improvement contractor. Hereinafter EarthFirst of New England, LLC and EarthFirst Excavation, LLC will be referred to as EarthFirst.

The first contract, executed on August 26, 2001, called for EarthFirst to "excavate for driveway per site plan and apply 6" of gravel to driveway. Clear trees and remove stumps from site. Install silt fence, clear site for driveway, house and septic." The second contract, the contract of February 22, 2002, obligated EarthFirst to install a septic system, excavate foundations for the house and garage, backfill the house foundation and excavate a utility trench and waterline trench. Both contracts were signed by Dennis Gelinas, homeowner, and David A. Fuss, member of EarthFirst of New England, LLC. n1

n1 The signature lines on each contract read as follows:

/s/

EarthFirst of New England, LLC

DAVID A. FUSS, MEMBER
LLC

/s/

HOMEOWNER

[*3]

Further evidence of the contractual relationship comes from EarthFirst invoices. On four different occasions EarthFirst billed the plaintiffs for work to be done or that it had completed. Each invoice was on EarthFirst letterhead and was signed by defendant Fuss as "member LLC."

There are no allegations that either contract violated the Home Improvement Act, *General Statutes § 20-418 et. seq.* Furthermore, the plaintiffs do not seek to hold Fuss liable by piercing the corporate veil.

LAW

First and Second Counts

The first and second counts of the complaint allege breach of the August 26, 2001 and February 22, 2002 contracts, respectively. The defendant argues that *General Statutes § § 34-133 and 34-134* shield him from being held personally liable on the contracts of the limited liability company.

On the face of the complaint, each of these counts appear to be directed solely toward the defendant EarthFirst. n2 Furthermore, during argument on this motion the plaintiffs' attorney stated that defendant Fuss, in his individual capacity, was never intended to be a part of the first and second counts.

n2 The pertinent sections of the complaint read:

> "*FIRST COUNT* 1) On or about August 26th, 2001, the Plaintiffs and the Defendant, Earth First of New England, LLC, acting by the Defendant David A. Fuss, entered into a contract for the construction of . . ." "*SECOND COUNT* 1) On or about February 22nd, 2002, the Plaintiffs and the Defendant Earth First of New England, LLC, acting by the Defendant David A. Fuss, entered into a contract for the construction of . . ."

[*4]

The court finds the following regarding the first and second counts of the complaint.

"The Connecticut Limited Liability Company Act, *General Statutes § § 34-100 to 34-242*, inclusive, was adopted in 1993 and is generally similar to the model act promulgated in 1995 by the Uniform Laws Commissioners. The allure of the limited liability company is its unique ability to bring together in a single business organization the best features of all other business forms--properly structured, its owners obtain both a corporate-styled liability shield and the pass-through tax benefits of a partnership." (Internal quotation marks omitted.) *PB Real Estate, Inc. v. DEM II Properties, 50 Conn. App. 741, 742, 719 A.2d 73 (1998).*

Section 34-133 addresses liability of members to third parties, as applied here the liability of Fuss to Gelinas. *Section 34-133* states: "Except as provided in subsection (b) of this section [concerning professional services not applicable to the present case] a person who is a member or manager of a limited liability company is not liable, solely by reason of being a member or manager, under a judgment, [*5] decree or order of a court, or in any other manner, for a debt, obligation or liability of the limited liability company, whether arising in contract, tort or otherwise or for the acts or omissions of any other member, manager, agent, or employee of the limited liability company." *General Statutes § 34-133.* Moreover, a member, individually, is not a proper party to suit on a breach of contract claim unless "the object of the proceeding is to enforce a member's or manager's right against or liability to the limited liability company." *General Statutes § 34-134.*

Furthermore, the defendant's statutory argument dovetails with the rule of agency law that states: "the agent is not liable where, acting within the scope of his authority, he contracts with a third party for a known principal." (Internal quotation marks omitted.) *Rich-Taubman Associates v. Commissioner of Revenue Services, 236 Conn. 613, 619, 674 A.2d 805 (1996).*

The contracts at issue are clear and unambiguous as to who the contracting parties were. The first paragraph in each contract states that this is an agreement "by and between EarthFirst of New England, [*6] LLC, David A. Fuss, member, P.O. Box 202, Brooklyn, CT, County of Windham, State of Connecticut, referred to herein as the 'Contractor,' and Dennis Gelinas, Town of Killingly, State of CT, referred to herein as 'Homeowner.' " Moreover, the signature line caption reiterates that Fuss is acting as an agent of EarthFirst as it reads: "EarthFirst of New England, LLC, DAVID A. FUSS, MEMBER LLC." Last, the invoices mailed to the plaintiff identify the billing party as "EARTHFIRST OF NEW ENGLAND, LLC" and are signed by "David A. Fuss, member LLC."

The defendant has met his burden of showing the absence of any material fact regarding Fuss's personal liability on the contracts and the plaintiff has failed to submit any evidence establishing the existence of any

disputed fact as to Fuss's personal liability. The defendant David A. Fuss is entitled to judgment as a matter of law since 1) the shield of *§ § 34-133 and 34-134* protect him from suit and 2) he did not contract with Gelinas as an individual, but rather as a member/agent of EarthFirst. The motion for summary judgment is granted to defendant Fuss on the first and second counts.

Third Count

The third count of the complaint alleges that [*7] Fuss, in his individual capacity, negligently performed the work that EarthFirst contracted with Gelinas to accomplish. The defendant argues that due to his status as a member of the company he cannot be found liable for negligence without the plaintiff first piercing the corporate veil. The defendant further contends that the plaintiffs have not alleged any facts that would support piercing the corporate veil.

The threshold issue is whether, due to his status as a member, Fuss is protected by the limited liability shield. In *Scribner v. O'Brien, Inc., 169 Conn. 389, 363 A.2d 160 (1975)*, the supreme court was presented with facts similar to the present case and on the issue of liability held: "It is true that the agent is not liable where, acting within the scope of his authority, he contracts with a third party for a known principal . . . It is also true that an officer of a corporation does not incur personal liability for its torts merely because of his official position. Where, however, an agent or officer commits or participates in the commission of a tort, whether or not he acts on behalf of his principal or corporation, he is liable to third persons injured [*8] thereby." (Citations omitted.) *Id., 404.* Although the *Scribner* court was addressing a situation where the defendant was an officer of a corporation, the court finds that the holding is equally applicable to a limited liability company since an hallmark of the limited liability company is its "corporate-styled liability shield." *PB Real Estate, Inc. v. DEM II Properties, supra, 50 Conn. App. 742.* Therefore, Fuss is a proper party to the third count, the plaintiff does not have to pierce the corporate veil and the defendant is not protected by *§ § 34-133 or 34-134.* See also *Nadler v. Grayson Construction Co.*, Superior Court, judicial district of Stamford-Norwalk at Stamford, Docket No. CV 02-0190015 (April 15, 2003, Adams, J.) (34 Conn. L. Rptr. 482) ("Although there is no case law interpreting *[§ 34-134]*, its plain language implies that a manager or a member [of a limited liability company] is a proper defendant in an action that is not based solely on his status as a member or a manager.")

The plaintiff's third count alleges that Fuss was negligent. "Issues of negligence are ordinarily not susceptible of summary adjudication but should [*9] be resolved by trial in the ordinary manner." (Internal quotation marks omitted.) *Fogarty v. Rashaw, 193 Conn. 442, 446, 476 A.2d 582 (1984).* Nevertheless, "the existence of a duty is a question of law and only if such a duty is found to exist does the trier of fact then determine whether the defendant violated that duty in the particular situation at hand." (Internal quotation marks omitted.) *Gould v. Mellick & Sexton, 263 Conn. 140, 153, 819 A.2d 216 (2003).* Thus, if no duty is found to exist then it is proper to grant summary judgment.

"The existence of a duty of care is an essential element of negligence . . . A duty to use care may arise from a contract, from a statute, or from circumstances under which a reasonable person, knowing what he knew or should have known, would anticipate that harm of the general nature of that suffered was likely to result from his act or failure to act." (Citation omitted.) *Coburn v. Lenox Homes, Inc., 186 Conn. 370, 375, 441 A.2d 620 (1982).*

In this case, the defendant EarthFirst owed the plaintiffs a contractual and a common-law duty. EarthFirst's contractual duty arises under Section I of each [*10] contract. Section I of each contract states that the "contractor shall be responsible for the following in addition to the workmanlike performance for the work done on the above stated premises." On a common-law basis, EarthFirst has a duty to "exercise that degree of care which a skilled builder of ordinary prudence would have exercised under the same or similar conditions." *Scribner v. O'Brien, Inc., supra, 169 Conn. 400.*

"The same standard of care that applies to a corporation [or limited liability company] also applies to an officer, manager, or agent of a corporation [or limited liability company] who individually approves, directs, or actively participates or cooperates in the negligent conduct." *Hoang v. Arbess, 80 P.3d 863, 870*, cert. denied, *2003 Colo. LEXIS 954 (Colo.Ct.App. 2003).* See also *Scribner v. O'Brien, Inc., supra, 169 Conn. 389.* (In this negligence claim, the court applied the same standard of care to the corporate officer sued in his personal capacity as it had applied to the corporation.)

In Fuss's answer to the complaint, he admits that he directed the affairs of EarthFirst and that [*11] he is the person who performed the work contracted for by EarthFirst under the two contracts. Due to this admission, Fuss is found to have owed the plaintiffs the same contractual and common-law duties that EarthFirst owed to the plaintiffs.

However, there is a genuine issue of material fact regarding whether Fuss breached his duty to the plaintiffs. This is a decision that must be left to the trier of fact. *Gould v. Mellick & Sexton, supra, 263 Conn. 153.*

Fuss has not met his burden of showing that there is an absence of material fact regarding negligence. Therefore, the motion for summary judgment is denied.

CONCLUSION

Based on the foregoing, defendant David A. Fuss's motion for summary judgment is granted as to the first and second counts. The defendant's motion for summary judgment on count three is denied.

Foley, J.